



## GOVERNOR'S TRANSACTION PRIVILEGE TAX SIMPLIFICATION TASK FORCE ONLINE RETAIL WORKING GROUP MINUTES

Tuesday, October 9, 2012

1:30 PM

1820 W. Washington, St. #200, Conference Room 101  
Phoenix, Arizona 85007

A public meeting of the Transaction Privilege Tax Simplification Task Force was convened on October 9, 2012 in Conference Room 101, 1820 West Washington, St. #200, Phoenix, Arizona 85007. Notice having been duly given. Present and absent were the following members of the Task Force.

### Members Present

Michael Hunter (Chair)  
Steve Barela  
Miguel Teposte  
Tom Belshe  
John Olsen

Keely Hitt  
Vince Perez  
Kevin McCarthy  
Lynne Herndon  
Senator John McComish

### Members Absent

Linda Stanfield

Representative Rick Gray

### Staff Present

Lorna Romero, Governor's Office  
Lindsay Scornavacco, Governor's Office

### 1. Call to Order

Michael Hunter called the meeting to order at 1:31 p.m.

### 2. Importance of a Uniform Base

Dennis Hoffman, Chair of the Online Retail Working Group, stated sales tax simplification would make an important contribution to the economic environment in Arizona. Establishing a uniform tax base is key to that effort. He continued that to eliminate distortions and to comply with federal legislation establishing a uniform tax base is important.

#### a) Working Group Discussion and Public Comment

Kevin McCarthy stated Arizona has always been in the top ten in the country for sales tax revenues and one of the lowest for income tax revenues. Unless policy flips the state's reliance on sales tax and income tax, Arizona needs to be mindful that people are incentivized to purchase items online with the current tax system. He continued that he agrees with the importance of having a uniform tax base and stated it will be an obvious requirement with federal legislation.

Tom Belshe stated he did not disagree with Mr. Hoffman's and Mr. McCarthy's comments, but the cities' concern is how this will be done without disrupting budgets. The work the Arizona League of

Cities and Towns and the Department of Revenue have done on the retail classification will also be done for all other categories.

Vince Perez commented he is in agreement with Mr. McCarthy and Mr. Belshe. He continued there is still more work to be done.

### **3. Online Travel Company Issues**

#### **a) Presentation: Mitch Bryk, Starwood Hotels & Resorts**

Mitch Bryk from Starwood Hotels & Resorts made a presentation on online travel companies and how hotel rooms are taxed differently when purchased from the hotel, through a travel agent or through an online travel company.

#### **b) Working Group Discussion and Public Comment**

Mr. Hoffman asked what the difference is between commission for travel agents and markups for online travel companies.

Mr. Bryk answered the markup is treated as a service fee, not as a room fee, with online travel companies.

Mr. Hoffman stated the arithmetic before taxation is identical. He asked if the difference is simply due to how the taxing jurisdiction treats the tax on commission versus markups.

Mr. Bryk responded that is correct.

Mr. Hoffman stated distortions would be eliminated if online travel companies were treated like travel agents. He asked what the impediment is to doing this.

Christie Comanita from the Department of Revenue stated online travel companies are not taxed at the state level. For Arizona purposes, that question is a city issue.

Miguel Teposte asked if all online travel companies follow the merchant model.

Mr. Bryk answered yes. He continued that hotels are obligated to charge tax on the full room rate and online travel companies are not. If customers go to the hotel's website, they will find the rates are within pennies of the online travel companies.

Keely Hitt asked if it was realistic for the customer to expect to pay the same rate through the hotel website, a travel agent or an online travel company. She continued that she thought it would be cheaper through an online travel company.

Mr. Bryk responded the room rates are the same and the final cost is typically within pennies through the different mechanisms. The difference is that through a hotel's website the consumer's credit card is not immediately charged and the consumer is subject to the hotel's cancellation policy rather than the online travel company's. He continued that the two dollar tax difference between the hotel's and the online travel company's taxes adds up to hundreds of millions of dollars around the country.

Mr. Teposte asked what the impact on hotels is when online travel companies buy their rooms.

Mr. Bryk answered that the sales from online travel companies amount to 6-7% of total room sales. For smaller hotels the impact can be 50-100%.

Ms. Hitt asked if the distortion could be fixed by saying there is no difference between online travel companies and the commission of travel agents.

Ms. Comanita stated the determining factor is what the hotel receives. The hotel is only receiving the discounted rate of \$80 from the online travel company. With travel agents, the hotel receives \$100. The commission and cost of doing business is done in a separate agreement.

Mr. Hoffman asked if other states have taxed the online travel companies the difference.

Mr. Bryk responded there would need to be a change in statute.

Lee Grafstrom from the Unified Audit Committee stated it is the opinion of the Unified Audit Committee that the difference is already covered in statute under the broker provision. It is the cities' perspective that the broker and principal are equally liable for the full amount charged to the consumer. He continued that the \$100 would be taxable via any purchasing mechanism.

Mr. Bryk commented the City of Scottsdale sued on this issue and won.

Senator McComish stated a simple solution could be that online travel companies charge \$112 instead of \$110. He asked if there would be a consumer rebellion with the additional costs or if online travel companies would be in uproar if they were to lose two dollars.

Mr. Bryk stated that in New York online travel companies have not increased their rates. These companies must continue to operate in a competitive market.

Mr. Hoffman asked if Starwood has a recommendation on this matter.

Mr. Bryk stated Starwood believes the full amount should be taxed, but does not actively propose legislation. An online travel company in Missouri sought an exemption from tax and Starwood was vigorously opposed to that.

#### **4. Establishing Sourcing for Remote Sales**

Mr. Perez stated the Department of Revenue had put together draft language based on the streamline movement and Utah sourcing language.

Ms. Comanita stated that the original position of the streamline movement was to have all destination based sourcing. Texas, New Mexico, Ohio, Utah and California all have origin based sourcing similar to Arizona. Ohio, Utah and Tennessee were very involved in the streamline movement to maintain origin based sourcing. She explained that an Amish furniture maker does not operate through the internet and has no way of paying taxes throughout the state. Origin based sourcing was offered as an option in 2007. This option was allowed under the condition that five states adopted it, but this requirement was removed in 2011. Ms. Comanita stated this option is a

starting point for Arizona to maintain some of the local revenue.

**a) Working Group Discussion and Public Comment**

Mr. Grafstrom stated origin based sourcing is a concern to the cities because revenues will shift. As long as origin based sourcing is maintained for local sales, the cities are more than willing to accept destination based sourcing for out-of-state sales. He continued that he expects this language to be adopted for the Model City Tax Code.

Michelle Ahlmer from the Arizona Retailers Association asked if the draft language would impact an internet seller who works out of his or her home in Arizona selling to Arizona residents. She asked if this would be origin or destination based sourcing.

Mr. Grafstrom stated it is the cities' perspective that it would be origin based because of its presence in Arizona.

Mr. Perez interjected that the language is drafted to capture all remote sales under destination based sourcing. The sale in Ms. Ahlmer's example would be subject to destination based sourcing.

Ms. Comanita stated this language also changes taxes for items shipped out of state. There will no longer be a difference if the purchaser is a resident or nonresident of Arizona; if an item is bought in Arizona and shipped out of state, it is not subject to tax.

Mr. Perez commented it is probably impossible to calculate a number for the impact that will have. The idea is that the amount of out-of-state sales that will be able to be captured will significantly offset other losses.

The working group took a break at 2:36 p.m.

**5. County vs. State Issues on Use Tax Due on Remote Sales**

The working group reconvened at 2:50 p.m.

**a) Presentation: Mark Barnes, County Supervisors Association**

Mark Barnes from the County Supervisors Association stated the counties would like to be sure that excise taxes do not get lost in discussion regardless of what decisions are made. If they are not considered, there is no parity and distortions will continue to exist. He continued that the counties would like to have a use tax provision put in statute to satisfy their issue of nexus. This was done in the late 1990's and would be appropriate again this session.

**b) Working Group Discussion and Public Comment**

Mr. Perez asked if the counties want the Department of Revenue to enact a use tax at the county level or to simply allow counties in statute to enact a use tax.

Mr. Barnes stated the statute would need to allow the counties to enact a use tax.

Ms. Comanita stated a subsection could be added to the statute that imposes use tax at the state level to allow counties to adopt that same mechanism.

Mr. McCarthy asked what the counties' concern is about not being covered in the online retail discussion.

Mr. Barnes stated the counties would just like equal footing with respect to nexus on the issue.

Ms. Comanita commented the majority of states have sales tax and use tax rates set at equal rates. Arizona is unique in that the use tax rate is different from the TPT rate.

Ms. Ahlmer stated from a retail perspective there is a lot of spending occurring on county islands and it would be a distortion of markets to continue without parity.

## **6. Update on Federal Legislation**

### **a) Presentation: Joe Rinzel, Retail Industry Leaders Association**

Joe Rinzel from the Retail Industry Leaders Association presented an update on relevant federal legislation. He discussed the Main Street Fairness Act, the Marketplace Fairness Act and the Marketplace Equity Act in Congress. There is discussion of combining these bills to create a fourth bill with bipartisan support. The goal of the Alliance for Main Street Fairness is to create an environment where states solve their own issues without a federal mandate. Their opinion is that there will be an opportunity to make progress in the lame duck session.

Mr. Grafstrom asked if the solutions the Task Force have proposed up to this point would satisfy federal requirements.

Mr. Rinzel stated he thinks all requirements would be covered except the small seller exemption.

Ms. Ahlmer encouraged the group to reach out to Arizona's Congressional members.

Mr. Hoffman asked if Mr. Rinzel knew the position of the Arizona delegation.

Mr. Rinzel responded he did not know specifically, but there is a sense that Senator Kyl is more open to the ideas than Senator McCain.

Ms. Hitt asked what the Governor's position is on these bills.

Mr. Hunter stated the Governor has been approached to take position on these bills, but she does not want to lose focus on what needs to happen in Arizona. There have also been conversations between a major online retailer and the Department of Revenue. These conversations have not been made public and it would be inappropriate and perhaps illegal to discuss them in the working group. He continued that the Governor is interested in the blended bill and has her staff member Ryan Serote in Washington D.C. to update her.

### **b) Update from Department of Revenue**

Mr. Perez stated the compromise bill should be made available in mid November which will allow the Department of Revenue to discuss the issue with the Governor's Office.

### **c) Working Group Discussion and Public Comment**

No comments were made.

## **7. Adjournment**

Mr. Grafstrom stated the Unified Audit Committee is working on a presentation of concepts and proposals for the working group to consider that should be made available two weeks before the next working group.

Mr. Hoffman stated the next working group meeting will be on Tuesday, November 13<sup>th</sup> at 9:00 a.m. at the League of Arizona Cities and Towns.

Mr. Hunter adjourned the meeting at 3:37 p.m.